RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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November 23, 1983 **LETTER 875**

Nov. 18 DJIA 1251.18; PTI 1775; A-D Ratio –15.18
Nov. 25 DJIA 1277.44; PTI 1790; A-D Ratio -14.79

THE PICTURE: The short interest is one of the market's best measures of pessimism (disbelief). Pessimism can be very profitable when it is aligned with a primary bear market. But when pessimism builds up within a primary bull market, the situation becomes explosive. In fact, there is nothing more bullish than a record amount of pessimism or disbelief–when that disbelief is positioned AGAINST a confirmed bull market.

On November 21, the NYSE announced that the short interest had risen to an all-time record 194 million shares. The short interest ratio (total short interest divided by average daily volume) for the October-November period rose to a whopping 2.34. With non-confirmations on the downside, with a record short interest locked into this primary bull market, it seems only a matter of time before the bull rises to his feet and starts climbing the stairs.

The odds are now greater than ever that the market is preparing for a major (perhaps huge) upward extension of this bull market. The situtation, to my mind, resembles a giant compressed spring which is cocked and ready to uncoil. But remember, it will uncoil in its own good time.

The page 2 chart shows the critical relationships that I've been writing about in recent Letters. Note at point "a" on the chart that Industrials broke below their October 3 low, (Oct. low is point "b" on the chart). But at "a" the Transportation Average refused to confirm. Now turn to the advance-decline ratio at point "a". Note that at point "a" the A-D ratio broke below its August low at point "c". But the Industrial Average at point "a" was far above its own point "c" (point "c"for Industrials is at 1163.06).

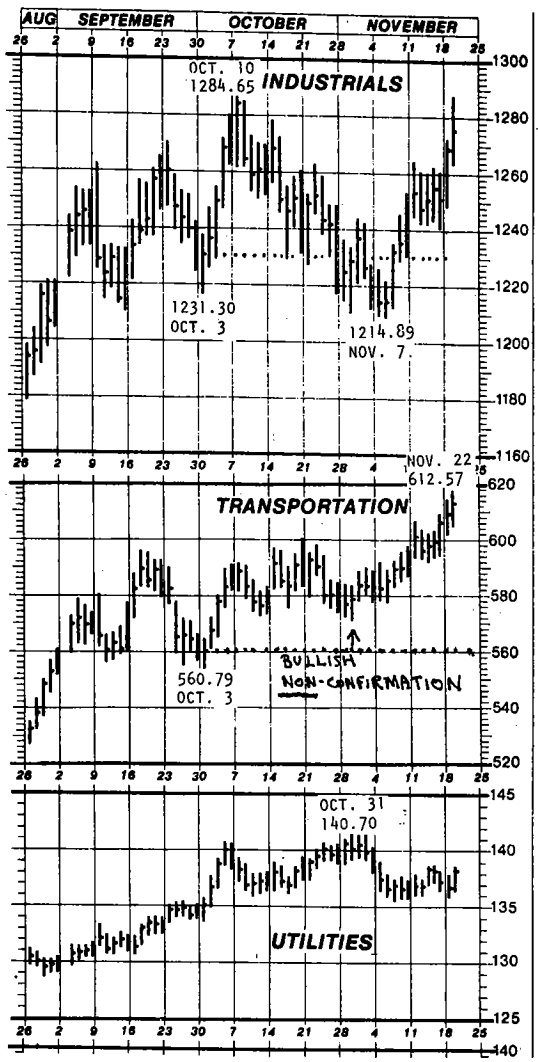
Thus, this bull market has seen two downside non-confirmations, a most interesting and unique situation. As I explained in the last letter, when a bear market is in progress, time is against the stockholder. In a bear market values are decreasing through time. Thus, in a period of five or six months what we could expect to see in a bear market is confirmations on the downside–ALL the averages and indicators breaking down. We don't expect to see dramatic downside resistance and we don't expect to see "double downside non-confirmations" such as we are seeing now. This is bull market action.

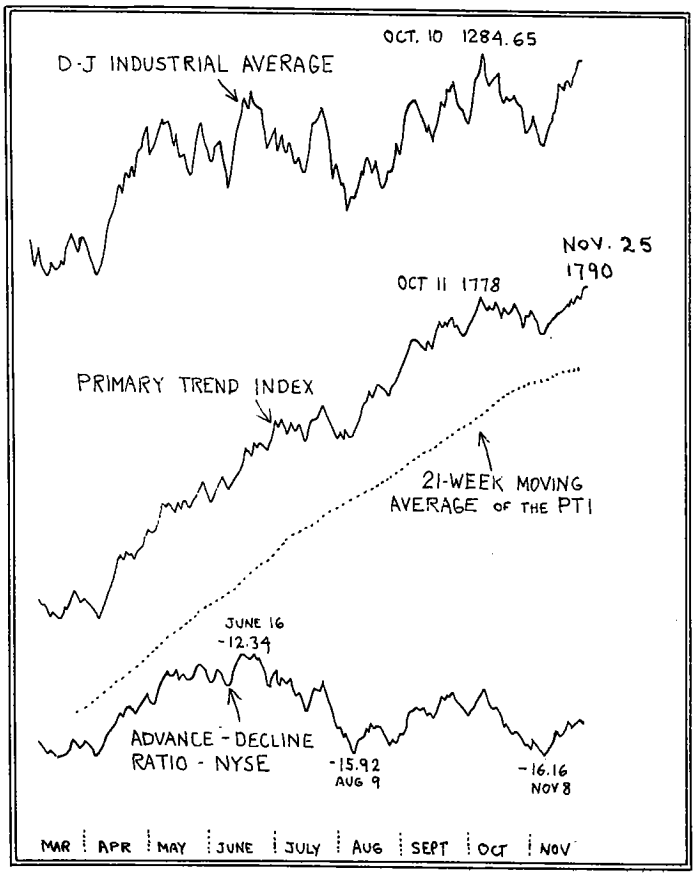
I have drawn horizontal dotted lines along each of these three indicators. I view the action within these horizontal lines as bull market accumulation areas. In time, I believe the area within the dotted lines will be seen as a platform for the next major leg of the bull market. But the next bull leg may take time–perhaps well into 1984.

For those who are impatient, it is well to remember that the *bigger the base* for the next bull advance, the further and higher that next leg is fated to go. So from the bull's standpoint, we might even hope that this accumulation will carry those dotted horizontal zones three or four months into 1984.

I cannot emphasize often enough that the operative fact, the prime investment fact, about the stock market today is that *a primary bull is in force.* If that is true (and I've been saying that it is true for over a year) then in due time the Averages, the A-D ratio and the majority of common stocks will be advancing to new highs. (Chart courtesy of Ned Davis Research (1/800-241-0621).

THOUGHTS: Most people who study or use technical analysis get so involved in the process that they forget what they are doing and why. The fact is that ALL technical analysis seeks to do just one thing–it seeks to determine whether the





stock market has discounted coming events or whether it has not.

For instance, when the market turns down and the averages start giving up the pointage, the big question is–"How far down does this market have to go before the worst is discounted?" When the market declines, it is always a reflection of one of two items: (1) either the market is correcting the excesses of prior speculations, or (2) the market is retreating because it sees something in the economic or political picture that it does not like. So again, we apply technical analysis in an effort to gauge where and at what point the market has discounted the worst.

The converse is true on the upside. When the market is advancing we use technical analysis to try to measure when and at what level the market has discounted the best. The market goes up for only two reasons: (1) It is bouncing up from a technically over-sold condition, or (2) the market is rising to discount improving business conditions that lie ahead.

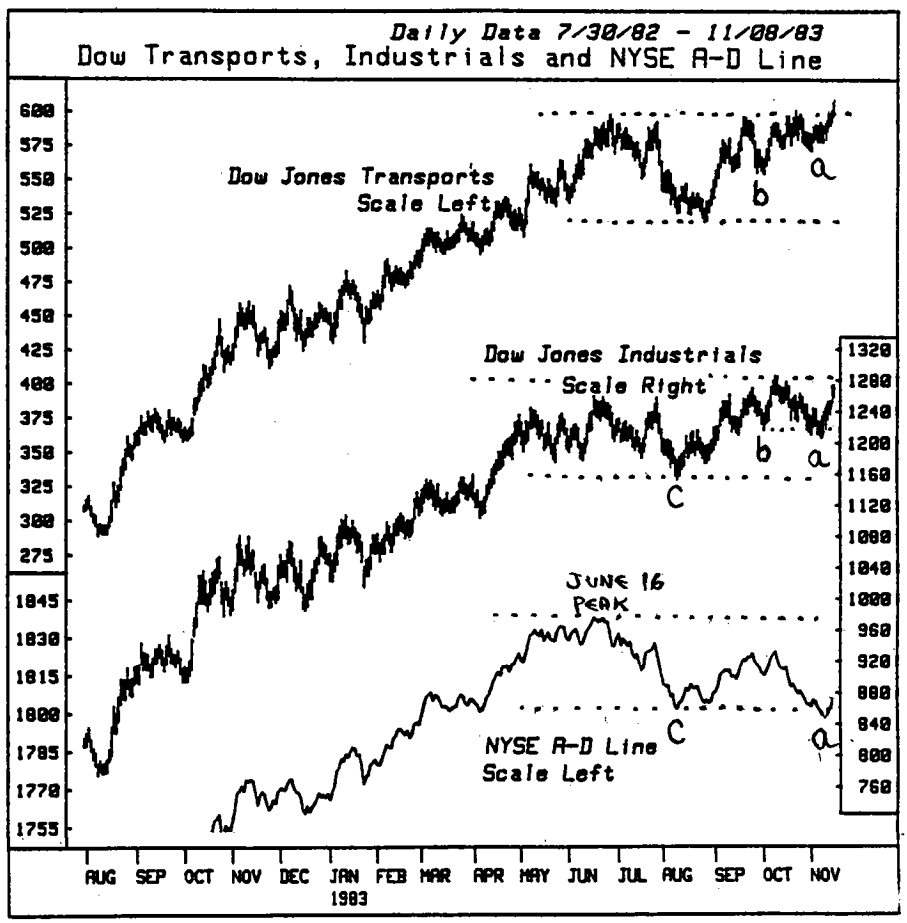
So that's what technical analysis is all about. The technical approach seeks to measure when a rising market is over-bought (i.e., has gone too far on the upside) or whether a declining market is over-sold (i.e., it has gone too far on the downside).

That may sound easy, but there are complications. There are complications because the stock market is subject to three movements, and these three movements can all occur simultaneously. (1) There is the minor movement which may last a day or a few days. (2) There is the secondary movement, that may last a few weeks to a few months or more, (3) Both of these movements may function within a primary movement. The primary movements we term bull or bear markets, and these can last from a few years to many years.

The single most important fact for any investor to know is the DIRECTION of the primary trend. In a bull market the broad direction is up for a few years to many years. The persistence of the generally rising market is, of course, the investor's best friend. A bull market tends to make all the optimists appear brilliant, it tends to bail out the fools, and it can often make jackasses wealthy. A primary bear market can make the pessimists look like geniuses, it will break many stockholders, and it will invariably bring many tycoons down to street level again.

The brokers on the New York Futures Exchange sport a badge that says, "The Trend is Your Friend". And that's definitely true, but there is one catch. It's not that easy to determine the trend, and if you are smart enough or lucky enough to know the trend–the next question is "How long will the trend last?" No badge at the Futures Exchange will tell you that one.

I have held to one basic premise in Letters written during 1982 and all this year. That premise is that *we are in a primary bull market.* During August 1982 to June 1983 the general market (as seen by the A-D ratio) headed up. The general market slumped after June, but the D-J Averages continued higher. Industrials hit a high of 1284.65 on October 10, and Trans-



ports hit a high of 612.57 on November 22. With the Averages at new record highs but unconfirmed by the majority of issues as measured by the A-D ratio, most analysts screamed "danger."

I took exception. I pointed out that it was true that the A-D ratio topped out in mid-June, it was also true that this was not necessarily the end of the bull market. There are two things that I love to see in a bull market. One is pessimism building up, and the record short interest on the NYSE told me that we indeed were witnessing a lot of pessimism within this bull market. The second item that I like to see is downside non-confirmations following a reaction. Downside non-confirmations tell me that the bull is resisting the downside–he doesn't want to go any lower. So when we get downside non-confirmations, a high short interest, skepticism among the public, the traders and the advisers, and a drying up of volume, the implications usually are that the market has DISCOUNTED THE WORST THAT CAN BE SEEN AHEAD. When the worst is discounted within a bull market, there is only one way the market can go. That way is UP. But that "up" may not occur immediately–it can take weeks or even months.

QUESTION: Russell, from every quarter I hear complaints that the Fed is putting the squeeze on, that the Fed is keeping interest rates high, that the Fed is on dangerous ground and that too much tight money will kill inflation but it will kill the stock market and the economy as well. What do you think?

Answer: Obviously, I can't read the Fed's mind, but I think four things are involved here. (1) The Fed is making it known (particularly to Congress) that it is not going to monetize the deficits. So by keeping the money supply on the tight side, the Fed is really saying, "Cut spending or raise taxes, but don't expect the Fed to bail you out." (2) The Fed, having been analyzed and "psyched out" for years by various experts, does not want to be predictable. The Fed does not want to do what everybody expects. And right now everyone expects the Fed to be accommodative. We'll see.

(3) The continuing high interest rates are going a long way toward keeping inflation low, and that's exactly what the Fed (and the President) want. The Fed evidently believes that today's economic recovery is strong enough to take the high interest rates. (4) The current "tight" stance of the Fed gives the Fed breathing space. My own guess is that the Fed would like to keep things on the tightish side through 1983 and into early 1984. Then the Fed will ease up as we move into election time, but they won't make it too obvious. My feeling is that the economy could respond rather explosively on the upside if the Fed eased up aggressively, and this is not what the Fed wants.

Question: What's your opinion as to where we, as investors, should be in the various markets today?

Answer: Of all the various markets, the one I feel most confident about now is the stock market. With disinflation or actual deflation in the saddle at present, the metals and most commodities appear unattractive to me. I like the T-bill markets, and I personally hold some long-term T-bonds (yields almost 12% now). Most of the leading brokerage houses offer completely liquid bill and bond funds, and this is an easy way to move into (and out of) the money markets.

Question: Russell, what do you like about the stock market? It hasn't done anything in months.

Answer: This is a primary bull market. The market is currently "resting" after the massive 1982-83 rise that ended for the majority of stocks when the A-D ratio peaked in mid-June of 1983. But look at it this way. We've had a steady stream of scary news, from Lebanon to Grenada to high interest rates to bank failures. We've had doom-reports on international bank loans, we've faced ghastly warnings from the hard money people and we've faced deflation fears. We've seen earnings collapse on selective stocks and we hear (almost hourly) the dire warnings about budget deficits and balance-of-payments deficits.

What this bull market has been doing, aside from correcting the historic rise of 1982-83, is absorbing mountains of bad news and scary news. But look at it this way. Here's the bad news pouring out, here's the short interest building to new record highs, here's a spate of record insider selling, here are T-bonds yielding almost 12%, and this market has stubbornly refused to fall apart. The fact is that during October and November the D-J Industrial and Transport Averages rose to all-time highs while the Utility Average hit a 14-year high. And the PTI (on November 21) advanced to a record high of 1779!

In my opinion (and I've said this repeatedly) the LONGER this market sits here and absorbs bad news, the longer this market absorbs the selling of the shorts and the bears, the bigger the upside move when the market finally heads higher. Remember, bad news doesn't kill a bull market. Pessimism doesn't kill a bull market. The only thing that kills a bull market is EXHAUSTION on the upside. When the bull market fully expresses itself, when the Averages and most stocks finally climb to the point where the best that can be seen ahead is fully reflected in the price structure--at that point the bull will breathe its last and the bear will take over.

But here is the point to consider–if this were actually a bear market then the bad news of the last six months would have crumpled the price structure. The market would now be in a state of collapse. Wall Street would be in shambles if we were truly in the grip of the bear.

So my feeling is that this is the time to own funds, no-load or even load funds, and closed end funds, funds that are well managed and funds that can participate in this bull market. I recommend sitting with those funds here, while the bull is absorbing the darts and arrows, and then probably adding to your holding when the bull market finally breaks out on the upside.

Thus, I see the stock market as the safest and most intelligent way of making money over the next year or so (or possibly longer).

NO-LOAD FUNDS VS. INDIVIDUAL STOCKS: For many years (actually decades) I have offered individual stock picks during bull markets. I changed this policy a few years ago. I have been doing quite a bit of thinking about the question of funds vs. stocks, and my thinking has clarified even further.

Every day a huge amount of work goes into analyzing and picking individual stocks. Analysts visit the companies, accountants pour over profit and loss statements, brokers attend corporate meetings. Ultimately, recommendations are made by brokerage houses, analysts and letter writers. But buying an individual

stock entails buying a situation with a lot of variables. The stock will be subject to its group cycle, mistakes can be made in the appraisal of the stock, problems can arise within the company, key executives can leave, and on and on.

Against this we have the alternative of determining the trend of the market and then buying (or selling) a fund that will hopefully outperform the market on the upside (or, again hopefully, at least keep up with the market during its bull phase).

Which is the better or safer procedure? In my opinion, the safer and more reliable procedure is investing with the trend of the market rather than trying to pick individual winners. One reason I say that is that it is very difficult to analyze a stock, and you or I have limited facilities with which to do ORIGINAL AND MEANINGFUL research. Put it this way, if you or I decide to buy National Corn Starch, we are at a disadvantage: We are competing with men who are intimately connected with the company, we are competing with insiders, and we are competing with analysts who have visited the company, have a first-hand knowledge of its plusses and minuses, and we are competing with professionals who are making a market in the stock of the company.

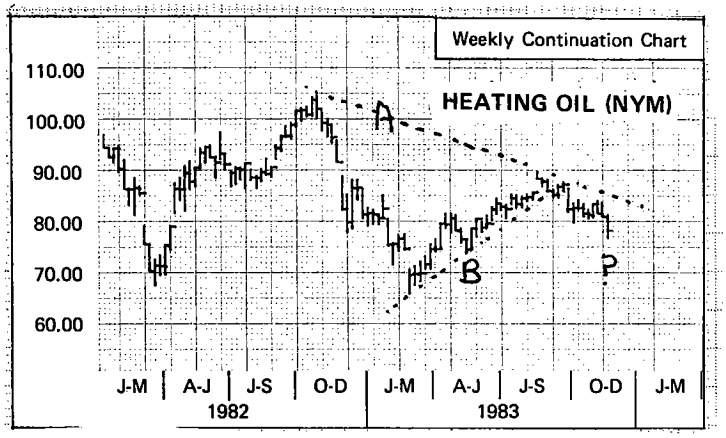
On the other hand, when it comes to the trend of the stock market, I feel that it is an equal game. In this endeavor, I have as much experience, as much data and (I think) more knowledge than most of the people in the business. I have a lot of faith in my ability to determine the trend of the market.

So my conclusion is that the odds are on the side of the investor who buys a fund in a bull market, rather than an investor who buys his five favorite stocks in what he hopes is a bull market. And my job is to tell subscribers when to be in the market with the funds and when to be out.

Oh yes, one more thing. It is very difficult to ride out a primary bull market with a group of your own pick of stocks. The reason is that individual stocks are subject to wide fluctuation–even during a bull market. On the other hand, the diversification of a fund usually smooths out the fluctuations, and thus you will find it *easier on your nerves* to sit with a fund rather than an individual stock. In fact, one of the reasons that so few people make real money during the life of a bull market is that they tend to trade in and out in individual stocks. Ultimately, as one stock after another corrects the stockholder gets worried and dumps his shares. And in the end, the bull market turns up and moves higher without him.

A few subscribers have written in to ask me to review mutual funds that have been recommended over the past year. Put it this way: I want you to hold all recommended funds until I finally give a major bear market sell signal. For new readers, the following funds may be purchased now: Fidelity Equity Income Fund (1/800-225-6190). Guardian Mutual Fund (1/212-850-8300). Lindner Fund (1/314-227-5305). (Note: this section takes the place of the usual Investment Position box).

NOTES & QUOTES: One commodity that is capturing the eyes of the investment world is heating oil. Since October. 1982, heating oil has been in a rather subtle downtrend. The oil has held below the longer bearish trendline (A on the chart) and in September oil broke below its shorter-term bullish trendline. The



question now is whether the oil will hold at the critical 70 level (these prices are in cents per gallon). If, and I say if, the oil breaks below $.70 it will be another most significant indication of deflation. Already the declining oil price has had an effect on the stock market. Lower fuel prices help the transportation and utility industry. And, of course, lower oil prices hurt the oil companies and those banks that are now loaded with oil loans (a few of these banks are now in trouble). Chart courtesy of Dunn & Hargitt, 22 N. Second, Lafayette, IN 47902.

* *

Most people are unaware of it, but the new military is going to be different than anything we see today–very different. And the money needed to develop the new weapons is going to be astronomical. Here's a piece from the last week's New York Times:

By WILLIAM J. BROAD

A TOP candidate has emerged in the Reagan Administration's quest for a technology to defend the United States from assault by enemy missiles. It would be smaller, cheaper and more powerful than other futuristic devices put forward in response to the President's "Star Wars" speech, an appeal eight months ago for the nation's scientists to develop a defensive shield in space. At the core of the candidate is a nuclear bomb.

Known as an X-ray laser, the device takes the power of a nuclear explosion and channels it into laser rods that emit lethal bursts of radiation in space. According to scientists at the Lawrence Livermore Laboratory in California, the birthplace of the device, clusters of X-ray lasers could stop the entire force of strategic Soviet missiles, currently some 1,500 strong. The lasers would literally pound the rockets apart with powerful X-ray beams.

A Presidential panel recently called on the Government to devote $895 million over the next five years to develop the X-ray laser — more than it recommended for any other technology uncovered in its search, as President Reagan put it, for the means of rendering nuclear weapons "impotent and obsolete."

* *

I want to warn subscribers again that anything that becomes too popular, and studies that develop too big a following on Wall Street--are apt to malfunction. One of the extremely popular studies today is "contrary opinion." For instance, almost every advisory service now quotes the "bull and bear" statistics put out by *Investors Intelligence.* This study shows the number of bulls on the market, the number of bears and the number of those expecting a correction. These statistics are now so widely distributed that I totally distrust them.

Back in September 1982 (and many of you probably remember this) Time magazine had on its cover a giant bull with a matching story on the "new bull market." For decades this kind of cover

(contrary opinion) would have suggested that no bull market was in sight–that the rise was simply a bear market correction. I posted that Time cover on my wall, because at the time, I suspected that this might be the time to take a contrary stance on contrary opinion. And, what do you know, the Time cover was absolutely correct! Conclusion regarding today's widespread and simplistic statements on contrary opinion–be careful, I don't trust most of them!

* *

From our "Southern California's Got Everything" Dept.: One of the most expensive mansions in La Jolla was recently sold to a former Iranian banker. The mansion is reputed to have cost around $10 million. There are few doubts about the nationality of the new owner. Each morning his son hoists the Iranian flag over the mansion, the Rollses and the Mercedes.

* *

In my opinion, we are slowly moving towards the time when the US Government will have to be cut back in size–or major financing trouble will result (this could be the basis for the next bear market–which I expect will hit around 1986 or 1987). It all comes down to my thesis that "politicians never, ever do anything until their backs are against the wall. And then they do as little as they can get away with." In other words, they will do just enough to bring the screams down to dull murmurs.

Speaking of the US Government, this little squib from the Nov. 23 NY Times is worth squinting at. It gives some idea of how bloated and how utterly fantastic the Washington beast has become.

Special to The New York Times

WASHINGTON, Nov. 22 — The Federal Government is, indeed, Big Business, spending more than $91 million an hour, 24 hours a day, and handling more than $1,700 billion in receipts and outlays annually.

So says the President's Private Sector Survey on Cost Control, a panel established by President Reagan on June 30, 1982 to examine ways to increase efficiency and reduce costs of Government.

The Federal Government, according to some calculations made recently by the panel, does these things:

¶Employs 2.8 million people.

¶Purchases more than $130 billion annually in goods and services.

¶Owns one-third of the United States land mass, an estimated 744 million acres, equal to all of the states east of the Mississippi River, plus Texas.

¶Occupies 2.6 billion square feet of office space, the equivalent of all the office space in the 10 largest cities in America times four.

¶Owns and operates 437,000 nonmilitary vehicles.

¶Provides 95 million subsidized meals a day.

¶Has more than 17,000 computers, 332 accounting systems and 319 payroll systems.

¶Issues 4.8 billion publications annually.

¶Delivers medical care to 47 million people.

"To effectively discharge these massive responsibilities," the report said, "the Federal Government needs a comprehensive and integrated strategy; an efficient and well-managed organizational structure; effective and responsive management systems; and competent, qualified and properly motivated employees."

* *

I don't often recommend investment books, but there is one writer whose work I always admire. He is John Train, an acute student of the market and a man who is an expert on investment procedures. John's new book, "Preserving Capital," is well worth the asking price of $17.95. (Potter is the publisher). By the way, John Train possesses three advantages over the average investment writer. (1) He understands money. (2) He is conservative. (3) He has a load of common sense plus he possesses a healthy skepticism.

* *

It has been said that "treason is just a matter of timing." I often feel that political enemies are just a matter of timing too. For instance, those of us who fought in World War II remember the hatred we felt for the Germans and the Japanese. If, back there in 1943, I could have foreseen that I would be living in an America swarming with Datsuns, Toyotas, Mercedes and BMWs I simply would not have believed it. But enemies are also a matter of timing.

Take Yasir Arafat and the PLO today. A year ago, Arafat was the darling of the world press. Now he is hiding in Tripoli while his army and followers are being slaughtered. What's changed? Syria has changed, and President Assad has moved to take over the lead of the Arab world. Arafat is in Assad's way–so Assad has decided to "eliminate" him. And the world couldn't care less. Now here's a thought–when Israel attacked Arafat, the world was horrified. When Syria attacks and pratically annihilates the PLO, well, pass the wake-up pills, buddy, and let me know how it all comes out.

* *

I spoke to Alan Abelson last week about doing an article for Barron's. I wrote my first Barron's article on December 1, 1958, and that article had to do with what I predicted would be a great stock market boom. The years following 1958 proved me correct. I followed that first article with a series of 16 additional pieces for Barron's on Dow Theory and the market. (The series ended in 1961).

Now, 25 years after my initial Barron's piece, I have submitted another article for Barron's. Obviously, I don't know whether Barron's will publish it, but if they do, it will probably be in the December 5th issue.

* *

GOLD, SILVER: Last week the excellent *Silver & Gold Report* (PO Box 60, Bethel, CT 06801) asked in big headlines, "Why Have Silver Prices Plunged Recently? What's Gone Wrong in the Silver Market?" They then explain that industrial demand is down for silver, and that silver is first an industrial metal and only secondarily a monetary metal.

None of which I disagree with. But my own opinion is that silver, gold and precious metals are still in the throes of a severe and prolonged primary bear market, a bear market that started in 1980 when the forces of inflation and deflation finally met head-on. The Fed's policy of monetizing the giant and growing US deficits was fundamentally inflationary. But during 1980 I wrote piece after piece explaining that debt creation was inflationary. I based this on (1) the tremendous *cost* of servicing a debt that is growing and compounding, and (2) the market's increasing sophistication,

which meant that each rise in the money supply was accompanied by a sliding bond market and therefore by HIGHER interest rates.

Which takes us to the present. The spector of massive budget deficits implies a financial squeeze (unless the debt is monetized, and the Fed shows no inclination to monetize all the new debts). So inflation is dying here in 1983. But even if the Fed decided to monetize the debt, the money markets would promptly react by swooning. This would bring on a collapse in business, and when business caves in while carrying its own high debts, we have a deflationary situation.

Then there is the problem of the massive, uncollectible bank loans to the Less-Developed Nations. These loans will be ultimately written off, and this means a tremendous loss of liquidity. So between the US debts and deficits and the foreign "uncollectibles", we have a basically deflationary environment. This, I feel, is the situation which is bringing the metal markets down and down.

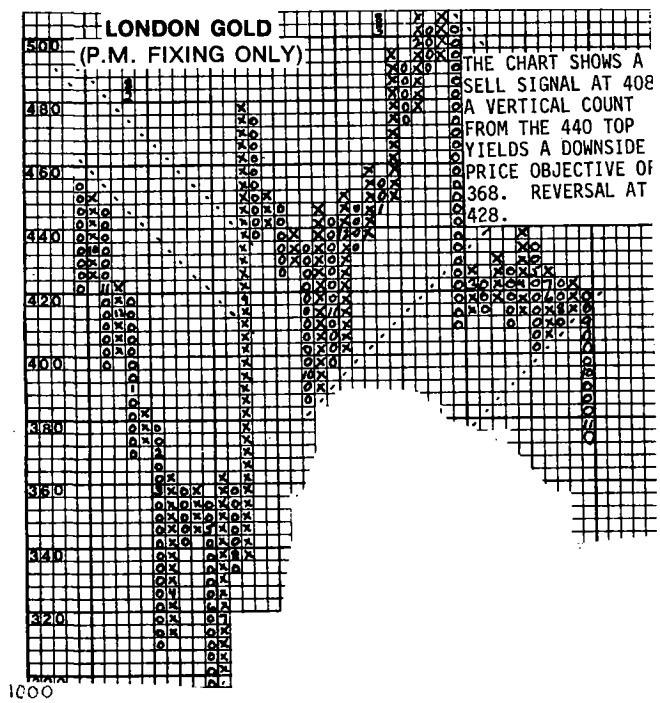
I include on this page my weekly chart showing the ratio of common stocks to gold bullion. The ratio is derived by dividing the London price of spot gold by the value for the NYSE Stock Index. These ratios are charted in the form of a 3-week and an 8-week moving average.

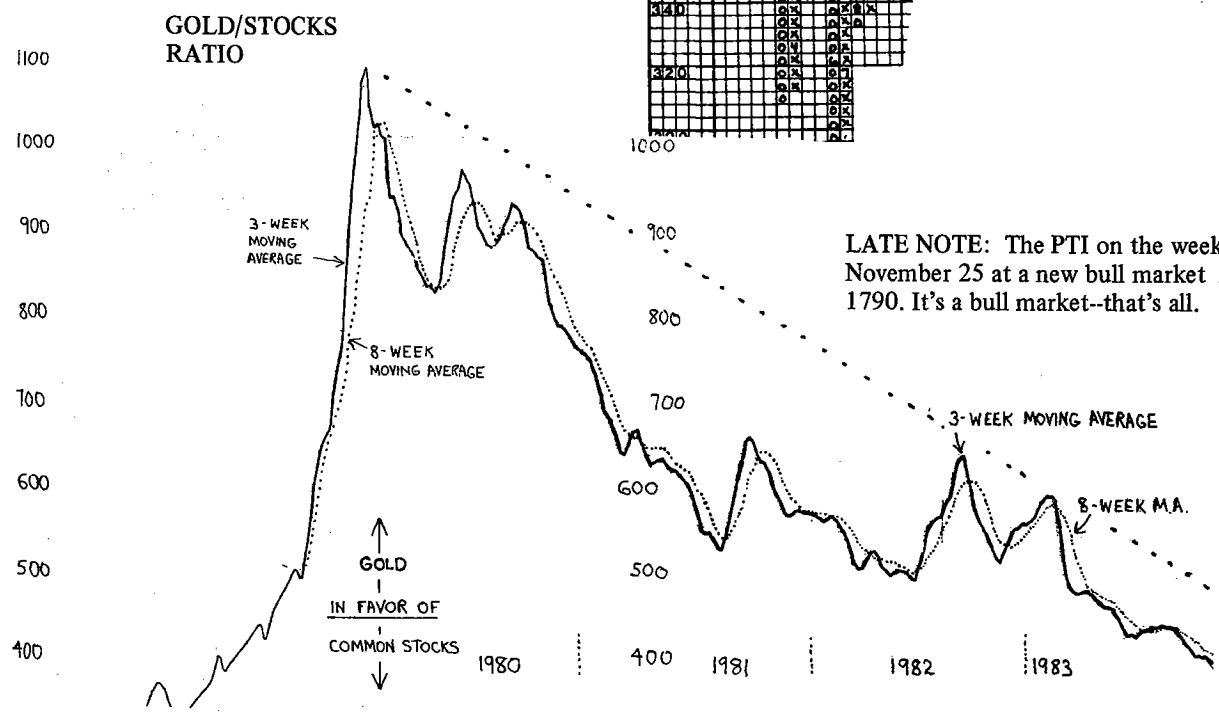
The study is valuable because it shows where money is going, or whether it is going into common stocks or into gold. In other words, it is a relative strength chart. I have found that when the ratio is going down in favor of stocks, this is generally a poor environment for gold and a good environment for stocks. And, of course, the reverse is true when the ratio is rising.

Last week both the 3-week and the 8-week ratios dropped to their lowest levels since 1980. The 3-week ratio dropped to 391, whereas at its January 17, 1980 high it was 1175. Note also that the 3-week MA is below the 8-week MA, and this means that this study is under the sell mode as far as gold is concerned.

The point & figure chart for gold shows the latest vicious break in the gold price. As a rule, following a long break and consolidation such as we see here on the chart, the next downside break should carry as far as the break from the high. If this occurs, the downside count for gold would be around 295-300. It could happen. We are in a primary bear market for the metals.

NEXT MAILING: Dec. 14





LATE NOTE: The PTI on the week ending November 25 at a new bull market high of 1790. It's a bull market--that's all.